Supreme Court, U.S.
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No. 94-

IN THE
Supreme Court of the United States
OCTOBER TERM, 1994

UNITED CAPITOL INSURANCE COMPANY,
Petitioner,

v.

NICHOLS & ASSOCIATES TRYON PROPERTIES, INC., *et al.*

Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

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PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED FOR REVIEW

Whether an Article I bankruptcy court may enter a final default judgment in a non-core adversary proceeding raising state law claims for breach of contract, in the absence of the express consent of the defendant.

LIST OF PARTIES AND RULE 29.1 LIST

The plaintiffs in the adversary proceeding below were Nichols & Associates Tryon Properties, Inc.; Tryon Associates, Limited; Connecticut Mutual Life Insurance Company; and Saybein Partners.

The defendants in the adversary proceeding below were Petitioner, United Capitol Insurance Company ("United Capitol"); Brunswick Insurance Agency, Inc., d/b/a the Brunswick Companies; Blue Ridge Insurance Services Agency, Inc.; Pilot Property Casualty Agency, Inc.; and Willis E. Fickey. Because the judgment of the court below was entered only against United Capitol, the other defendants were not parties to the appellate proceedings.

The parent company of Petitioner United Capitol is Capsure. United Capitol has no non-wholly owned subsidiaries to list pursuant to Rule 29.1.

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PETITION FOR A WRIT OF CERTIORARI

United Capitol Insurance Company petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fourth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals for the Fourth Circuit was not officially reported. It is reprinted in the Appendix at 1a-9a.

The order of the district court was not officially reported. It appears in the Appendix at 10a-11a.

The order of the bankruptcy court was not officially reported. It is reprinted in the Appendix at 12a-22a.

STATEMENT OF JURISDICTION

The judgment of the court of appeals was entered on September 14, 1994. The court of appeals denied Petitioner's petition for rehearing with suggestion for rehearing *en banc* on October 18, 1994 (App. at 23a-24a). The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1) (1988).

CONSTITUTIONAL PROVISION, STATUTES AND REGULATIONS INVOLVED

This case involves the following constitutional provision:

U.S. Const., Article III, § 1

This case involves the following statutes and regulations, which are set forth in full in the Appendix at 30a-31a:

28 U.S.C. § 1334(b) (1988)

28 U.S.C. § 157(c) (1988)

Fed. R. Bankr. P. 7008(a)

Fed. R. Bankr. P. 7012(b)

STATEMENT OF THE CASE

This case arises from an adversary proceeding filed in the United States Bankruptcy Court for the Western District of North Carolina by Nichols & Associates Tryon Properties, Inc. ("Nichols"), Saybein Partners ("Saybein"), Tryon Associates, Limited ("Tryon"), and Connecticut Mutual Life Insurance Company ("Connecticut Mutual") against Petitioner United Capitol Insurance Company ("United Capitol"). The initial proceeding sought to recover the proceeds of a physical damage insurance policy issued by United Capitol covering the Tryon Mall in Charlotte, North Carolina, which was destroyed by fire on April 18, 1989.

Approximately three months before the fire, Nichols had acquired the Tryon Mall, which was subject to a first

deed of trust held by Connecticut Mutual and a second deed of trust held by Tryon. Nichols promptly defaulted on the mortgage payment due to Tryon, and a foreclosure sale of the Tryon Mall was scheduled for March 28, 1989. On that date, just hours before the foreclosure sale, Nichols recorded the deed to the Tryon Mall property and submitted the premium payment to United Capitol for the insurance policy covering the property; Nichols then filed a voluntary petition for Chapter 11 bankruptcy.

In accordance with the automatic stay provisions of the Bankruptcy Code, the foreclosure sale of the Tryon Mall was postponed. The bankruptcy court subsequently lifted the automatic stay to allow the sale of the Tryon Mall on April 17, 1989, which Tryon purchased for $1,677,580. Approximately twelve hours after the sale, in the early morning of April 18, 1989, a fire broke out in the Tryon Mall, resulting in heavy damage.

Nichols, Saybein, Tryon, and Connecticut Mutual entered into a consent order authorizing their joint prosecution of claims against United Capitol for the proceeds of the insurance policy. Pursuant to that consent order, they filed an adversary proceeding in the bankruptcy court asserting various state law claims against United Capitol for its denial of coverage.

This case questions the subject matter jurisdiction of the bankruptcy court to render binding orders and enter final judgment in that adversary proceeding. The jurisdiction of an Article I bankruptcy court is limited: Upon referral by the district court, a bankruptcy court may exercise plenary jurisdiction only over matters at the "core" of the bankruptcy proceeding. While a bankruptcy court may hear a "non-core" matter, it must submit proposed findings of fact and conclusions of law to the district court for *de novo* review. Only the district judge is authorized to issue binding orders or enter final judgment in a non-core proceeding, unless the parties have consented to the exercise of jurisdiction by the bankruptcy court.

The jurisdictional allegation in the Amended Complaint provided:

> This Court has jurisdiction over this adversary proceeding pursuant to 28 U.S.C. § 1334 and § 157, because this action arises in and relates to the bankruptcy cases of Saybein Partners, Case No. C-13-90-30579-MRW-11 and Nichols & Associates Tryon Properties, Inc., Case No. C-B-89-30349, presently pending before this Court. *This adversary proceeding is a core proceeding pursuant to § 157(b).*

(emphasis added). In its Answer to the Amended Complaint, United Capitol denied the jurisdictional allegations. United Capitol did not file a written consent to the jurisdiction of the bankruptcy court or waive its right to trial of the state law claims by an Article III court.

The bankruptcy court treated the case as a "core" proceeding: Less than six months after United Capitol had filed its Answer to the Amended Complaint denying jurisdictional allegations, and in the absence of its express consent to the jurisdiction of the bankruptcy court, the bankruptcy court entered default judgment against United Capitol as a sanction under Fed. R. Civ. P. 37(b)(2)(c) and imposed damages in the full amount claimed by Nichols. There had been no other proceedings before the bankruptcy court; the only orders entered were those related to the discovery dispute which led to the default judgment.

United Capitol filed a timely appeal to the United States District Court for the Western District of North Carolina from (1) the Order Compelling Discovery entered by the bankruptcy court on February 8, 1991; (2) the Order Imposing Sanctions and default judgment entered by the bankruptcy court on June 18, 1991; and (3) the Order disposing of United Capitol's Motion for Relief from Judgment or Order entered by the bankruptcy court on July 25, 1991. The district court also treated the matter as a "core" proceeding: It reviewed the bank-

ruptcy court's orders on appeal, subject to a clearly erroneous standard of review. By Order dated May 24, 1993, the district court affirmed all orders on appeal.

On appeal United Capitol, in addition to seeking review of the default judgment, challenged the jurisdiction of the bankruptcy court to enter the orders and final judgment.[1] On the merits of the appeal (which are not presented to this Court for review), the court of appeals reversed the district court and vacated the bankruptcy court's order and default judgment, and remanded the case to the district court with instructions to remand the case to the bankruptcy court to consider the effectiveness of lesser sanctions.

On the jurisdictional issue, the court of appeals first correctly held that the adversary proceeding was a non-core proceeding, over which the bankruptcy court could not exercise jurisdiction absent consent of the parties. However, the court further held that "United Capitol *impliedly* consented to the bankruptcy court's adjudication of the adversary proceeding." (App. at 7a) (emphasis added). Because the issue of implied consent was not the focus of earlier briefs, United Capitol filed a timely Petition for Rehearing and Suggestion for Rehearing En Banc. In its petition, United Capitol pointed out to the court of appeals that the consent required for the bankruptcy court to enter a final order or judgment in a non-core proceeding cannot be implied by mere acquiescence in the bankruptcy court's supervision of pre-trial discovery proceedings, but that the consent must be express. The court of appeals denied the petition without opinion.

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[1] Although the jurisdiction of the bankruptcy court had not been raised in the district court, the lack of subject matter jurisdiction can be raised at any time. *United States v. Corrick*, 298 U.S. 435, 440 (1936).

REASONS FOR ALLOWANCE OF THE WRIT

The court of appeals has decided an important question of federal law which has not been, but should be, settled by this Court: Whether an Article I bankruptcy court may enter a final judgment in a non-core adversary proceeding raising state law claims for breach of contract, in the absence of express consent of the defendant? The writ of certiorari should issue for two reasons:

First, an Article I bankruptcy court is not constitutionally empowered in a non-core adversary proceeding to enter a final judgment in the absence of express consent. The Fourth Circuit's decision that consent to the entry of final judgment by a bankruptcy court in a non-core proceeding raising state law claims can be implied has impermissibly expanded the scope of federal jurisdiction of an Article I court beyond the constitutional limits established by this Court in *Northern Pipeline Constr. Co. v Marathon Pipe Line*, 458 U.S. 50 (1982).

Second, there is a direct conflict among the courts of appeals that have addressed the issue presented: The Fourth Circuit's decision in this case and a prior case, *Canal Corp. v. Finnman (In re Johnson)*, 960 F.2d 396 (4th Cir. 1992), is in direct conflict with the decisions of the Seventh and Eleventh Circuits, both of which have held that consent to the entry of judgment by a bankruptcy court in a non-core proceeding must be expressly given. Like the court below, both the Eighth and Ninth Circuits have held that consent may be implied.

I. AN ARTICLE I BANKRUPTCY COURT IS NOT CONSTITUTIONALLY EMPOWERED IN A NON-CORE ADVERSARY PROCEEDING TO ENTER A FINAL JUDGMENT IN THE ABSENCE OF EXPRESS CONSENT.

By holding that consent to the entry of final judgment by the bankruptcy court in a non-core proceeding raising state law claims could be implied, the Fourth Circuit im-

permissibly expanded the scope of federal jurisdiction of an Article I court beyond the constitutional limits set by this court in *Northern Pipeline Constr. Co. v. Marathon Pipe Line*, 458 U.S. 50 (1982). In *Northern Pipeline*, this Court struck down section 241(a) of the Bankruptcy Reform Act of 1978, 28 U.S.C. § 1471 (Supp. IV 1976), as an unconstitutional grant of power because it empowered an Article I bankruptcy court to hear and decide controversies required by the Constitution to be heard by an Article III court. Although a plurality decision, seven members of this Court joined in or expressed agreement with the narrow holding central to the present case: That Congress may not vest in a non-Article III court the power to adjudicate, render final judgment, and issue binding orders in a traditional contract action arising under state law, without consent of the litigants, subject only to ordinary appellate review. 458 U.S. at 84 (plurality opinion); *id.* at 90-92 (opinion concurring in judgment); *id.* at 92 (Burger, C.J., dissenting). This case presents the question whether the constitutionally required consent to the exercise of jurisdiction by a bankruptcy court must be express, so as to waive the right to have traditional state law claims adjudicated by an Article III court, or can consent be implied by mere acquiescence in the bankruptcy court's supervision of pretrial discovery matters.

In response to this Court's decision in *Northern Pipeline*, Congress passed the Bankruptcy Amendments and Federal Judgeship Act of 1984 (BAFJA), 28 U.S.C. § 151 *et seq.* (1988). Using the word coined by this Court in *Northern Pipeline*, the BAFJA distinguished between issues at the "core" of the bankruptcy jurisdiction, and adversary proceedings which are "non-core" but nonetheless related to the bankruptcy proceeding. Section 157(c) of the BAFJA codifies the plurality decision in *Northern Pipeline*, defining the limits of the bankruptcy court's power to adjudicate non-core matters. Section 157(c) provides:

> (1) A bankruptcy judge may hear a proceeding that is not a core proceeding but that is otherwise related to a case under title 11. In such proceeding, the bankruptcy judge shall submit proposed findings of fact and conclusions of law to the district court, and any final order or judgment shall be entered by the district judge after considering the bankruptcy judge's proposed findings and conclusions and after reviewing de novo those matters to which any party has timely and specifically objected.
>
> (2) Notwithstanding the provisions of paragraph (1) of this subsection, the district court, with the consent of all the parties to the proceeding, may refer a proceeding related to a case under title 11 to a bankruptcy judge to hear and determine and to enter appropriate orders and judgments, subject to review under section 158 of this title.

28 U.S.C. § 157(c) (1988). This case involves a non-core proceeding raising state law claims for breach of contract, just like the claims considered by this Court in *Northern Pipeline*. The bankruptcy court did not submit proposed findings of fact and conclusions of law to the district court as contemplated by section 157(c)(1). Rather, it entered binding orders and final judgment, to be reviewed by the district court only on appeal. Thus, the bankruptcy court's jurisdiction exists, if at all, under section 157(c)(2), requiring consent of the parties.

In holding that consent to the jurisdiction of the bankruptcy court in a non-core proceeding can be implied, the court below has sought to expand the jurisdictional reach of the bankruptcy court beyond the constitutional limits established by this Court in *Northern Pipeline*. Although neither this Court nor Congress expressly stated that *Northern Pipeline* and its codification in the BAFJA require express consent, any other interpretation would constitute "jurisdiction by ambush."

Valid consent is the linchpin of the constitutionality of 28 U.S.C. § 157(c). Section 157(c) was modeled

after section 636(c) of the Federal Magistrates Act, 28 U.S.C. § 631 *et seq.* (1979) (amended 1988 and 1990) which although not an exact parallel, is also a "referral" statute based on the same constitutional underpinnings: The Constitution requires that the judicial power of the United States be vested in courts having judges with tenure during good behavior and undiminishable compensation in order to protect judicial acts from executive or legislative coercion. This Court has had occasion to consider (and uphold) the referral provision of the Federal Magistrates Act in *United States v. Raddatz*, 447 U.S. 667 (1980), but has not opined on the consent required for a determination by a magistrate. In contrast to the confusion among the circuits regarding the consent required for the exercise of jurisdiction by an Article I bankruptcy court, the circuit courts that have construed the consent requirement of 28 U.S.C. § 636(c) have consistently held that consent to the jurisdiction of a United States magistrate must be "clear and unambiguous" and cannot be inferred. *Adams v. Heckler*, 794 F.2d 303, 306-07 (7th Cir. 1986); *Geaney v. Carlson*, 776 F.2d 140, 142 (7th Cir. 1985); *Trufant v. Autocon, Inc.*, 729 F.2d 308, 309 (5th Cir. 1984); *Glover v. Alabama Board of Corrections*, 660 F.2d 120, 124 (5th Cir. 1981). Even the Ninth Circuit, which has allowed implied consent to suffice for the exercise of jurisdiction by a bankruptcy court (*see infra* at 14-15) has held under 28 U.S.C. § 636(c) that:

> a clear and unambiguous expression of consent is required to vest the magistrate with authority under subsection (c). In the absence of a clear statement by the parties, the voluntariness of consent cannot be protected and could be faced in any case with a retroactive attempt to expand or contract the magistrate's authority. We will not permit our jurisdiction to depend on inferences when both the statute and common sense call for precision.

Alaniz v. California Processors, 690 F.2d 717, 720 (9th Cir. 1982) (citations omitted). And the Sixth Circuit (which has suggested, in dictum, that implied consent may be sufficient to confer jurisdiction on a bankruptcy court; *see infra* at 12, n.4) has held that express consent is required to confer jurisdiction on a magistrate. *Ambrose v. Welch*, 729 F.2d 1084, 1085 (6th Cir. 1984). Indeed, even the court below has recognized express consent as necessary to the constitutionality of referral to a magistrate. *Wimmer v. Cook*, 774 F.2d 68, 76 (4th Cir. 1985). Because an Article I bankruptcy judge lacks the Article III protection to the same extent as a magistrate, both should require the same express consent.

Although Congress did not directly state in the BAFJA that the required consent must be express, the issue was addressed when the 1987 Amendments to the Rules of Bankruptcy Procedure were adopted by Order of this Court on March 30, 1987 (effective August 1, 1987) ("the Rules"). The Rules were amended in direct response to the BAFJA and, as expressly stated in the Preface: "[t]he rules are also designed to adapt to amendments to the Code by Congress necessitated by *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*" Rule 7008(a) was amended to provide, in part:

> In an adversary proceeding before a bankruptcy judge, the complaint, counterclaim, cross-claim, or third-party complaint shall contain a statement that the proceeding is core or non-core and, if non-core, that the pleader does or does not consent to entry of final orders or judgment by the bankruptcy judge.

Fed. R. Bankr. P. 7008(a).[2] Similarly, Rule 7012 was amended to require that the defendant in an adversary

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[2] Because the Amended Complaint in the proceedings below alleged, incorrectly, that this adversary proceeding was a "core" proceeding, the statement of consent was not required pursuant to Rule 7008.

proceeding must admit or deny the allegation as to whether the proceeding is core or non-core:

> A responsive pleading shall admit or deny an allegation that the proceeding is core or non-core. If the response is that the proceeding is non-core, it shall include a statement that the party does or does not consent to entry of final orders or judgment by the bankruptcy judge. *In non-core proceedings final orders and judgments shall not be entered on the bankruptcy judge's order except with the express consent of the parties.*

Fed. R. Bankr. P. 7012(b) (emphasis added).[3] The Advisory Committee Note to Rule 7012(b) confirms: "A final order of judgment may not be entered in a non-core proceeding heard by a bankruptcy judge unless all parties *expressly* consent, 28 U.S.C. § 157(c)" (emphasis added). In its "Letter of Transmittal by Advisory Committee to Standing Committee on Rules of Practice and Procedure," the Advisory Committee explained the reason for requiring express consent:

> Section 157(c)(2) permits the parties to consent to entry of final order or judgment by a bankruptcy judge. To avoid what became known in the bankruptcy practice prior to the Reform Act as "jurisdiction by ambush" and to satisfy the statutory requirement for consent, the Advisory Committee included in Rules 7008 and 7012 a requirement that the consent of the parties to entry of final orders and judgment by the bankruptcy judge in non-core proceedings be expressly given.

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[3] United Capitol denied the jurisdictional allegation in its Answer to the Amended Complaint, as required by Rule 7012. Although United Capitol failed to include a statement that it did not consent, as required by the Rule, the Advisory Committee Note to Rule 7008 provides:

> Failure to include the statement of consent does not constitute consent. Only express consent in the pleadings or otherwise is effective to authorize entry of a final order or judgment by the bankruptcy judge in a non-core proceeding.

Notwithstanding the constitutional limitations of Article III as interpreted by this Court in *Northern Pipeline* and as codified by Congress in section 157(c) of the BAFJA, and notwithstanding the clear mandate of the 1987 amendments to the Rules, the court of appeals has held in this case that consent to the entry of final orders and judgments by an Article I bankruptcy court in a non-core proceeding may be implied by mere acquiescence in the bankruptcy court's supervision of pre-trial discovery proceedings. This expansion of the bankruptcy court's "jurisdiction by ambush" is at odds with the Constitution, the statute, the Bankruptcy Rules, and the decisions of two other courts of appeals. This important question of federal jurisdiction warrants review by this Court to provide clear and authoritative guidance to lower courts and litigants alike.

II. THERE IS A DIRECT CONFLICT AMONG THE UNITED STATES COURTS OF APPEALS FOR THE VARIOUS CIRCUITS THAT HAVE ADDRESSED THE ISSUE PRESENTED.

In the wake of *Northern Pipeline*, and in the absence of a decision from this Court, six courts of appeals have had occasion to consider whether the constitutionally required consent for the adjudication of state law claims by a bankruptcy court may be implied.[4]

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[4] Two other circuits (the First and Sixth) have addressed the issue only in dicta; the Sixth Circuit held, in *DuVoisin v. Foster (In re Southern Indus. Banking Corp.)*, 809 F.2d 329 (6th Cir. 1987) that the defendant had expressed consent to the jurisdiction of the bankruptcy court by agreeing to the entry of the bankruptcy court's order granting the motion to intervene and by pleading, in its Answer to the Intervening Complaint, that "[t]he defendant admits jurisdiction of the [bankruptcy] Court." *Id.* at 331. But, notwithstanding the express consent, the Sixth Circuit noted with approval that "recent cases in the bankruptcy courts that have supported the notion that the absence of a timely objection to the bankruptcy court's jurisdiction constitutes implied consent to the resolution of the controversy." *Id.* The First Circuit, in *In re G.S.F. Corporation*, 938 F.2d 1467 (1st Cir. 1991) found that

In addition to the decision below, three circuits (the Second, Eighth and Ninth) have held that consent may be implied by the absence of timely objection to the exercise of jurisdiciton. On the other hand, two circuits (the Seventh and Eleventh) have rejected implied consent as a sufficient basis for the exercise of jurisdiction and held that consent must be expressly given by the litigants. This Court should grant review to resolve this direct conflict among the courts of appeals which have disagreed over the meaning of this Court's decision in *Northern Pipeline*.

The Second Circuit was first to consider this issue, in *Men's Sportswear, Inc. v. Sasson Jeans, Inc. (In re Men's Sportswear, Inc.)*, 834 F.2d 1134 (2d Cir., 1987). While noting that "a court should not lightly infer from a litigant's conduct consent to have private state created rights adjudicated by a Non-Article III bankruptcy judge," *id.* at 1138, the Second Circuit nonetheless concluded that:

> [defendant's] failure to object to Judge Lifland's assumption of "core jurisdiction" at any point in these extensive proceedings before the bankruptcy court and the further failure to object to any part of the appeal process in the district court constitutes consent to the final adjudication of this controversy before the bankruptcy court."

Id. at 1137-38. The Second Circuit's decision, however, was rendered prior to the amendment of the Rules. Later *In re Men's Sportswear* was criticized by a district court which refused to follow the otherwise binding decision of the Second Circuit, observing that the decision predated the 1987 amendments to the Rules and concluding that those amendments warranted a different result. *Bennett v. Genoa AG Center, Inc. (In re Bennett)*, 154 B.R. 126

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consent was made explicit by filing of a "Stipulation and Release" with the bankruptcy court for entry as a final judgment, but the First Circuit suggested, in dicta, that it was not necessary that consent be explicit; but that implied consent would have sufficed. *Id.* at 1477.

(Bankr. N.D.N.Y. 1992). The district court in *Bennett* held that:

> It is significant that the court in *Men's Sportswear* supported its conclusion with pre-1987 amendment cases and did not make any mention of the amended Rule 7012(b). See *In re Men's Sportswear,* 834 F.2d at 1138. In light of the foregoing, present law seems to mandate that parties must expressly consent to the entry of a final order by the bankruptcy court in the determination of non-core matters.

Id. at 139-40. However, not all courts have agreed. In addition to the Fourth Circuit's decision in this case, both the Eighth and Ninth Circuits have reached the wrong result, even after the 1987 amendments to the Rules.[5]

The Ninth Circuit addressed the issue for the first time before the 1987 amendments in *Daniels-Head & Assoc. v. William M. Mercer, Inc. (In re Daniels-Head & Associates),* 819 F.2d 914 (9th Cir. 1987). Acknowledging the absence of express consent to the exercise of jurisdiction by the bankruptcy court, and the absence of a knowing and voluntary waiver of the right to *de novo* review by an Article III court, the Ninth Circuit nonetheless held that:

> The fact that Congress failed to include any provision for explicit consent in the 1984 Act indicates that consent implied from the parties' actions is sufficient.

Id. at 918-19. Although that decision was rendered before the promulgation of the plain language of the 1987 amendments to the Rules, the Ninth Circuit had another opportunity to consider the issue after the effective date

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[5] The First Circuit, which has not yet had the issue squarely presented, has suggested in dicta, after the effective date of the amendments to the Rules, that implied consent would be sufficient. See note 4, *supra.*

of the amendments in *Mann v. Alexander Dawson, Inc. (In re Mann)*, 907 F.2d 923 (9th Cir. 1990). Despite the new and clear rule, the Ninth Circuit continued to follow its earlier decision, perpetuating the rule in that circuit for implying consent to the jurisdiction of an Article I bankruptcy court over non-core matters of state law. The Eighth Circuit also considered the issue after the effective date of the amendments. *Abromowitz v. Palmer*, 999 F.2d 1274 (8th Cir. 1993). It relied on the pre-amendment precedents established by the Second and Ninth Circuits, holding that the required consent could be implied.[6]

In contrast, both the Seventh and Eleventh Circuits have squarely held that only express consent will suffice to confer jurisdiction on an Article I court. The Seventh Circuit considered the issue in *Home Insurance Co. v. Cooper & Cooper, Ltd.*, 889 F.2d 746 (7th Cir. 1989). There, the bankruptcy court had specifically requested that the parties file briefs concerning the issue of jurisdiction, and held that parties who did not respond had thereby consented to jurisdiction. The Seventh Circuit vacated the decision, holding that the consent must be presented to the district court (not the bankruptcy court), and holding that only written consent suffices. Specifically referring to the recent amendments to the Rules and addressing the objective reliability of the express consent rule, the Seventh Circuit explained:

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[6] The cases considered by the Eighth and Ninth Circuits, which found implied consent sufficient, involved cases in which the parties objecting to the exercise of jurisdiction by the bankruptcy court had themselves chosen the forum, either by filing the bankruptcy proceeding, as in *Abromowitz* and *In re Daniels-Head*, or by initiating the adversary proceedings in the bankruptcy court, as in *In re Mann*. United Capitol, by contrast, did not choose to litigate any claim in the bankruptcy court. Rather, United Capitol was sued as a defendant in the bankruptcy court by Nichols, and United Capitol affirmatively denied the allegation of jurisdiction.

> [S]ilence is not a solid basis for an inference of consent, and even actual consent before the bankruptcy judge cuts the district judge out of the process. Express consents filed with the district judge may be rejected; consent inferred from silence in the bankruptcy court changes the locus of the decision as well as the method of resolving the question.

Id. at 749-50.

Thereafter, in *Internal Revenue Service v. Dade Helicopter Jet Service, Inc. (In re Brickell Inv. Corp.)*, 922 F.2d 696 (11th Cir. 1991), the Eleventh Circuit considered and rejected implied consent as a basis for jurisdiction, again relying on the clear language of the Rules. As that court stated:

> The debtors' counsel argues that the IRS chose its forum and the procedures to be applied by filing claims against the bankruptcy estate and has therefore consented to the jurisdiction of the bankruptcy court. At most, the I.R.S. can have been said to have impliedly consented to the jurisdiction of the bankruptcy court over a $7,430 fee award. Bankruptcy Rule 7012(b), however, requires *express* consent.

Id. at 702 (emphasis in original). *Accord*, *Gower v. Farmers Home Admin. (In re Davis)*, 899 F.2d 1136 (11th Cir.), *cert. denied*, 498 U.S. 981 (1990).

The Fourth Circuit is the most recent court of appeals to address the issue. It was presented with the issue for the first time in *In re Johnson, supra*, decided after the 1987 amendments, but in a case that was commenced prior to the effective date of the amendments. The Fourth Circuit held that the issue presented in the bankruptcy court was a "core" proceeding, for which consent was not required. *Id.* at 402. But, as an alternative holding, the Fourth Circuit stated that:

> [E]ven if the distribution was not a core matter, it is at least a non-core related matter to which, in these circumstances, the parties impliedly consented to

> allowing the bankruptcy court to enter a dispositive order.

Id. at 402. In the case now presented for review, the Fourth Circuit had an opportunity to correct its earlier error in *In re Johnson*. Instead, the court compounded its error by holding that consent may be implied, even in this non-core proceeding raising purely state law claims. The Fourth Circuit thus joins the Eighth and Ninth Circuits, standing squarely in conflict with the Seventh and Eleventh Circuits on this important question of constitutional law and federal jurisdiction. In the face of Congress' pronouncement and the clear import of the Rules, this conflict among the circuits can only be resolved by this Court.

CONCLUSION

The Fourth Circuit's decision in this case expands the jurisdictional reach of an Article I bankruptcy court beyond constitutional limits. By implying consent to the exercise of jurisdiction by the bankruptcy court, the Fourth Circuit has allowed mere acquiescence in the bankruptcy court's exercise of jurisdiction over pre-trial matters to constitute a waiver of the constitutional right to have state law claims decided by an Article III court. Two other circuit courts have directly considered the issue and have reached the opposite result. Review is warranted to resolve this conflict between the circuits, and to answer the question raised by this Court in *Northern Pipeline*.

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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January, 1995

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APPENDIX

APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 93-1753

IN RE: NICHOLS & ASSOCIATES TRYON PROPERTIES, INCORPORATED; IN RE: SAYBEIN PARTNERS, a New York General Partnership,

Debtors.

NICHOLS & ASSOCIATES TRYON PROPERTIES, INCORPORATED; TRYON ASSOCIATES, LIMITED; CONNECTICUT MUTUAL LIFE INSURANCE COMPANY; SAYBEIN PARTNERS,

Plaintiffs-Appellees,

v.

UNITED CAPITOL INSURANCE COMPANY,

Defendant-Appellant,

BRUNSWICK INSURANCE AGENCY, INCORPORATED, d/b/a The Brunswick Companies; BLUE RIDGE INSURANCE SERVICES AGENCY, INCORPORATED; WILLIS E. FICKEY,

Defendants-Appellees,

and

PILOT PROPERTY CASUALTY AGENCY, INCORPORATED,

Defendant.

Appeal from the United States District Court
for the Western District of North Carolina, at Charlotte.
Graham C. Mullen, District Judge.
(CA-91-231-3-MU, CA-91-251-3-MU)

Argued: March 7, 1994

Decided: September 14, 1994

Before RUSSELL and MICHAEL, Circuit Judges, and RONEY, Senior Circuit Judge of the United States Court of Appeals for the Eleventh Circuit, sitting by designation.

OPINION

PER CURIAM:

Appellant United Capitol Insurance Company ("United Capitol") appeals from an order of the district court affirming the bankruptcy court's entry of a default judgment against it. For the reasons stated herein, we vacate the decision of the district court and remand for further proceedings consistent with this opinion.

I.

This appeal arises from an adversary proceeding filed in the bankruptcy court by Nichols & Associates Tryon Properties, Inc. ("Nichols"), Saybein Partners ("Saybein"), Tryon Associates, Limited ("Tryon"), and Connecticut Mutual Life Insurance Company ("Connecticut Mutual") against United Capitol to recover the proceeds of a physical damage insurance policy issued by United Capitol covering the Tryon Mall in Charlotte, North Carolina, which was destroyed by fire on April 18, 1989.

Approximately three months before the fire, Nichols had acquired the Tryon Mall, which was subject to a first deed of trust held by Connecticut Mutual and a second deed of trust held by Tryon. Because Nichols defaulted on the payment due to Tryon, the Superior Court of Mecklenburg County, on March 6, 1989, entered an order authorizing a foreclosure sale of the Tryon Mall on March 28, 1989.

On March 13, 1989, Nichols applied to United Capitol for physical damage insurance covering the Tryon Mall. United Capitol approved the coverage, which insured the Tryon Mall in the amount of $4,200,000 for physical damage loss to "real property" and $980,000 for "loss of rents." The policy designated "Aubry B. Nicholas and Associates, Inc." as the named insured.[1]

On March 28, 1989, Nichols recorded the deed to the Tryon Mall property, submitted a premium payment to United Capitol, and filed a voluntary petition for Chapter 11 bankruptcy. In accordance with the automatic stay provisions of the bankruptcy code, the foreclosure sale of the Tryon Mall authorized by the Mecklenburg County court was postponed. The bankruptcy court subsequently lifted the automatic stay on April 17, 1989 to allow the sale of the Tryon Mall, which Tryon purchased for $1,677,580.[2] Approximately twelve hours after the sale, in the early morning of April 18, 1989, a fire broke out in the Firestone store located in the Tryon Mall, resulting in heavy damage.

In February 1990, Nichols' trustee in bankruptcy submitted to United Capitol a "Proof of Loss" which estimated Nichols' total damages to be $273,424. Because of what it claimed were irregularities in connection with the issuance of the policy, United Capitol denied coverage for the claim. Nichols, Saybein, Tryon, and Connecticut Mutual filed an adversary proceeding in the bankruptcy

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[1] Nichols subsequently amended the policy to designate "Aubrey G. Nichols and Associates, Inc." as the named insured. By this same amendment, Nichols named Connecticut Mutual and Tryon as the first and second mortgagees.

[2] After it purchased the Tryon Mall at the foreclosure sale, Tryon assigned its interest in the property to Saybein Corporation. Saybein Corporation thereafter conveyed the property to Saybein Partners, which currently owns the mall and has itself filed a voluntary petition for relief under Chapter 11 of the bankruptcy code.

court asserting various state law claims against United Capitol for its refusal to provide coverage.[3]

After several months of discovery, the bankruptcy court, citing United Capitol's continued failure to comply with the court's discovery orders, granted judgment by default against United Capitol in the amount of $272,424. United Capitol appealed to the district court, contending that the bankruptcy court had abused its discretion by imposing such a harsh sanction. The district court affirmed, finding that the bankruptcy court had "properly applied the four-part test of *Mutual Federal Savings & Loan v. Richards & Associates*, 872 F.2d 88 (4th Cir. 1989)." United Capitol now appeals to this court.

II.

On appeal, United Capitol contends that the bankruptcy court erred when it entered a default judgment against United Capitol because it did not have jurisdiction over the adversary proceeding. We disagree.

Federal bankruptcy courts, like the federal district courts, are courts of limited jurisdiction. Their jurisdiction is defined by 28 U.S.C. §§ 157 and 1334. We begin our analysis with 28 U.S.C. § 1334(b), which grants the district courts jurisdiction over three categories of bankruptcy proceedings: 1) civil proceedings "arising under"

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[3] To avoid litigation regarding entitlement to the insurance proceeds, the Nichols trustee, Saybein, Connecticut Mutual, and Tryon negotiated a consent order authorizing the joint prosecution of the claim against United Capitol. The consent order also directs that any recovery from United Capitol will be applied as follows: first, in payment of legal fees and expenses incurred in connection with the litigation; second, in reimbursement of any expenses incurred by Saybein to clear the fire site; third, in payment of unpaid property taxes for the years 1988 and 1989 on the Tryon Mall property; and the balance in payment to Connecticut Mutual. The consent order also gives the Nichols trustee a claim against the Saybein bankruptcy estate, the amount of which is dependent upon the amount of the ultimate recovery from United Capitol.

the bankruptcy code; 2) civil proceedings "arising in" a case under the bankruptcy code; and 3) civil proceedings "related to" a case under the bankruptcy code. Because the bankruptcy court, as a unit of the district court, derives its jurisdiction from the district court, we must first determine whether the adversary proceeding filed against United Capitol is subject to the jurisdiction of the district court as set out in section 1334(b).

Appellees contend that the adversary proceeding at issue here comes under the district court's jurisdiction because it is "related to" the Nichols bankruptcy case. The courts of appeals have developed various definitions of what constitutes a "related to" case under section 1334(b). Under the Third Circuit's definition, which we cited with approval in *A.H. Robins Co. v. Piccinin*, 788 F.2d 994, 1002 n.11 (4th Cir.), *cert. denied*, 479 U.S. 876 (1986), a civil proceeding is related to bankruptcy when "*the outcome of that proceeding could conceivably have any effect on the estate being administered in bankruptcy,*" *Pacor, Inc. v. Higgins*, 743 F.2d 984, 994 (3d Cir. 1984) (emphasis in original). "[E]ven a proceeding which portends a mere contingent or tangential effect on a debtor's estate meets the broad jurisdictional test articulated in *Pacor.*" *Nat'l Union Fire Ins. Co. v. Titan Energy, Inc.* (*In re Titan Energy, Inc.*), 837 F.2d 325, 330 (8th Cir. 1988).

Applying the *Pacor* definition to the case before us, we find that the adversary proceeding filed against United Capitol could conceivably have an effect on the Nichols bankruptcy estate. Under the terms of the consent order, the insurance proceeds will be used to pay expenses which would otherwise be charged to the estate. Thus, requiring United Capitol to cover the disputed claim will reduce the total amount of claims lodged against the estate, leaving more of the estate's general assets available for use in creating a viable plan of reorganization. Accordingly, we conclude that the adversary proceeding filed against United Capitol was sufficiently related to the Nichols bankruptcy

to have allowed the district court to exercise jurisdiction under section 1334(b).[4]

Because the bankruptcy court derives its jurisdiction from the district court pursuant to 28 U.S.C. § 157, our determination that the district court had jurisdiction pursuant to section 1334(b) does not end the analysis. We must next determine whether, under 28 U.S.C. § 157, the bankruptcy court had jurisdiction to hear and enter final orders in the adversary proceeding filed against United Capitol.

Section 157 separates bankruptcy litigation into three categories: 1) core proceedings; 2) non-core related proceedings; and 3) non-core unrelated proceedings. *Canal Corp. v. Finnman* (*In re Johnson*), 960 F.2d 396, 399 (4th Cir. 1992). Bankruptcy judges are authorized to enter appropriate orders and judgments in core proceedings. 28 U.S.C. § 157(b)(1). Bankruptcy judges may also hear non-core related proceedings, but they may not enter final orders absent the consent of all the parties. 28 U.S.C. § 157(c)(2).

The meaning of "core proceedings" is illuminated by the context in which it appears. Subsection 157(b)(1) vests full judicial power in bankruptcy courts over "core proceedings arising under title 11, or arising in a case under title 11." Core proceedings, thus, must "arise in" or "arise under" a title 11 case. *Wood v. Wood* (*Matter of Wood*), 825 F.2d 90, 96 (5th Cir. 1987); 1 *Collier Bankruptcy Manual* § 3.01 at 3-37 (3d ed. 1993). An "otherwise related to" proceeding, therefore, can never constitute a core matter because, by definition it relates to the bankruptcy in a way different from one that does "arise in" or "arise under" a title 11 case. 1 *Collier on Bankruptcy* § 3.01 at 3-37; *Canal Corp.*, 960 F.2d at 402

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[4] United Capitol raises several issues in its brief concerning the entitlement of appellees to the insurance proceeds. These issues, however, go to the merits of the adversary proceeding rather than to the jurisdictional issue before us.

(holding that related proceedings "cannot be treated as core proceedings pursuant to [*Northern Pipeline Constr. Co. v.*] *Marathon* [*Pipe Line Co.*, 458 U.S. 50 (1982),] and 28 U.S.C. §§ 157(b)(1), (c)(1) and (c)(2)").

Because the adversary proceeding at issue here is "otherwise related to" the Nichols bankruptcy, i.e., not one which "arises in" or "arises under" the title 11 case, we find that it is a non-core proceeding. As noted above, a bankruptcy judge may hear non-core related proceedings but may not enter final orders. 28 U.S.C. § 157(c)(1). Where, however, a bankruptcy judge has the consent of all the parties, it may enter appropriate orders and judgments. 28 U.S.C. § 157(c)(2).

Here, we find that United Capitol impliedly consented to the bankruptcy court's adjudication of the adversary proceeding. *See Canal Corp.*, 960 F.2d at 403 (holding that "a party can impliedly consent to entry of judgment by the bankruptcy court in a non-core related matter"). Despite repeated opportunities before the bankruptcy and district courts to object to the bankruptcy court's exercise of jurisdiction over the adversary proceeding filed against it, United Capitol remained silent, acquiescing in the bankruptcy court's authority to enter appropriate orders and judgments in the matter. We therefore reject United Capitol's contention that the bankruptcy court was without authority to enter orders in the disputed adversary proceeding.[5]

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[5] In its answer to the appellees' amended complaint, United Capitol demanded a jury trial. United Capitol contends that this jury demand divested the bankruptcy court of jurisdiction over the adversary proceeding because bankruptcy courts are not authorized to conduct jury trials. *See Official Comm. of Unsecured Creditors v. Schwartzman (In re Stansbury Poplar Place, Inc.)*, 13 F.3d 122, 128 (4th Cir. 1993) (holding that "bankruptcy judges are not authorized to conduct jury trials"). We disagree.

United Capitol's jury demand did divest the bankruptcy court of jurisdiction to conduct a jury trial. *Stansbury*, 13 F.3d at 128 (holding that "where the Seventh Amendment provides the right

III.

In addition to challenging the bankruptcy court's jurisdiction to enter a default judgment against it, United Capitol contends that it was an abuse of discretion for the court to do so.

Rule 37(d) of the Federal Rules of Civil Procedure gives trial courts wide discretion to impose sanctions for a party's failure to comply with its discovery orders. *Mut. Fed. Sav. & Loan v. Richards & Assocs.*, 872 F.2d 88, 92 (4th Cir. 1989). Where, however, the sanction imposed is judgment by default, a trial court enjoys less discretion because such a decision eclipses a party's right to a trial by jury and a fair day in court. *Id.* This court, therefore, has developed a four-part test which a trial court must apply before it may enter a default judgment. *Id.* Pursuant to this test, a court must consider: "(1) whether the noncomplying party acted in bad faith; (2) the amount of prejudice his noncompliance caused his adversary . . . ; (3) the need for deterrence of the particular sort of noncompliance; and (4) the effectiveness of less drastic sanctions." *Id.*

In its sanctions order, the bankruptcy court stated that it had "considered the imposition of [other] sanctions" but had concluded "that there is no reasonable expectation that such 'lesser' sanctions would either remedy the de-

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to a jury trial . . . it must take place in the district court"). Contrary to United Capitol's contention, however, a valid jury demand does not strip a bankruptcy court of its jurisdiction to supervise discovery, conduct pre-trial conferences, and rule on pending motions. *E.g., Stansbury*, 13 F.3d at 128; *Jobin v. Kloepfer (In re M & L Business Mach. Co.)*, 159 B.R. 932, 934 (D. Colo. 1993); *Stein v. Miller*, 158 B.R. 876, 879-80 (S.D. Fla. 1993); *Allied Stores Corp. v. Fed. Ins. Co. (Matter of Federated Dep't Stores, Inc.)*, 144 B.R. 993, 997 (Bankr. S.D. Ohio 1992); *Business Communications, Inc. v. Freeman*, 129 B.R. 165, 166 (N.D. Ill. 1991); *City Fire Equip. Co. v. Ansul Fire Protection*, 125 B.R. 645, 648-50 (N.D. Ala. 1989). Thus, until a proceeding is ready for trial, a bankruptcy court may continue to oversee pre-trial matters.

faults noted in this Order or would adequately meet, redress and deter other conduct in the future, both by this party and other parties." J.A. 202. Although the court's order does state that it considered the effectiveness of less drastic sanctions, it does not identify which alternate sanctions it considered or explain why they could not remedy the situation as effectively as a default judgment. We find that such a conclusory statement does not satisfy this court's requirement that a trial court consider the effectiveness of less drastic sanctions. *See Wilson v. Volkswagen of America, Inc.*, 561 F.2d 494, 520 (4th Cir. 1977) (reversing entry of default judgment because, among other things, the district court "never gave any thought to the possibility of an alternative sanction 'lesser' in effect than one granting default judgment"), *cert. denied*, 434 U.S. 1020 (1978).

We accordingly vacate this portion of the bankruptcy court's order and remand the case to the district court with instructions to remand the case to the bankruptcy court to investigate the effectiveness of less drastic sanctions.

VACATED AND REMANDED WITH INSTRUCTIONS

[Filed May 25, 1993]

IN THE DISTRICT COURT
OF THE UNITED STATES
FOR THE WESTERN DISTRICT OF
NORTH CAROLINA
CHARLOTTE DIVISION

C-C-91-231-MU
C-C-91-251-MU

IN RE: NICHOLS & ASSOCIATES TRYON PROPERTIES, INC.,
Debtor.

IN RE: SAYBEIN PARTNERS, c/o EMES Management Corporation, 919 Third Avenue, New York, New York 10022, a New York General Partnership,
Debtor.

NICHOLS & ASSOCIATES TRYON PROPERTIES, INC., TRYON ASSOCIATES LIMITED, CONNECTICUT MUTUAL LIFE INSURANCE COMPANY and SAYBEIN PARTNERS,
Plaintiffs,

VS.

UNITED CAPITOL INSURANCE COMPANY, BRUNSWICK INSURANCE AGENCY, INC., d/b/a THE BRUNSWICK COMPANIES, BLUE RIDGE INSURANCE SERVICES AGENCY, INC., PILOT PROPERTY CASUALTY AGENCY, INC., and WILLIS E. FICKEY,
Defendants.

ORDER

This matter is before the Court on appeal by United Capitol Insurance Company from Orders entered by the Bankruptcy Court on February 7, 1991, June 18, 1991, and July 25, 1991. Oral argument was heard in these matters on May 21, 1993.

Based upon a review of the complete record as oral argument of counsel, it appears that the Bankruptcy Court properly applied the four-part test of *Mutual Federal Savings & Loan v. Richards & Associates,* 872 F.2d 88 (4th Cir. 1989). It further appears that the Bankruptcy Court's decisions were based upon underlying findings that are not clearly erroneous. The Court finds that the Bankruptcy Court did not abuse its discretion in imposing sanctions on United Capitol. Based upon the reasoning of the Bankruptcy Court, the Orders on appeal are hereby AFFIRMED.

IT IS SO ORDERED.

This 24th day of May, 1993.

/s/ Graham C. Mullen
GRAHAM C. MULLEN
United States District Judge

[Filed Jun. 18, 1991]

UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF
NORTH CAROLINA
CHARLOTTE DIVISION

Case No. 89-30349
(Chapter 11)

IN RE: NICHOLS & ASSOCIATES TRYON PROPERTIES, INC.,
Debtor.

Case No. 90-30579
(Chapter 11)

IN RE: SAYBEIN PARTNERS, c/o EMES Management Corporation, 919 Third Avenue, New York, New York 10092, a New York General Partnership,
Debtor.

Adversary Proceeding No.: 90-0206

NICHOLS & ASSOCIATES TRYON PROPERTIES, INC., TRYON ASSOCIATES LIMITED, CONNECTICUT MUTUAL LIFE INSURANCE COMPANY and SAYBEIN PARTNERS,
Plaintiffs,

vs.

UNITED CAPITOL INSURANCE COMPANY, BRUNSWICK INSURANCE AGENCY, INC., d/b/a THE BRUNSWICK COMPANIES, BLUE RIDGE INSURANCE SERVICES AGENCY, INC., PILOT PROPERTY & CASUALTY AGENCY, INC., and WILLIS E. FICKEY,
Defendants.

ORDER IMPOSING SANCTIONS

THIS CAUSE came on for hearing before the undersigned United States Bankruptcy Judge, on June 11, 1991 at 9:30 a.m. on the plaintiff Saybein Partners' ("Saybein") Motion for Sanctions against the defendant United Capitol Insuarnce Company ("United Capitol") pursuant to Fed.R.Civ.P. Rule 37(b)(2). Saybein was represented by Mr. James P. Cooney III of Kennedy Covington Lobdell & Hickman; the plaintiff Nichols & Associates Tryon Properties, Inc. was represented through its Trustee by Richard M. Mitchell of Mitchell & Rallings; and United Capitol was represented by Mr. Charles T. Francis of LeBoeuf, Lamb, Leiby & MacRae.

The Court, after reviewing the pleadings in this case, including the Motion for Sanctions, Response to Motion for Sanctions, Memorandum of Law and the supporting materials and affidavits presented by the parties, and after considering the argument of all counsel present, makes the following findings of fact:

1. This is an adversary proceeding that is a core proceeding under 28 U.S.C. § 157(b).

2. The plaintiffs in this cause, Nichols & Associates Tryon Properties, Inc., Tryon Associates Limited, Connecticut Mutual Life Insurance Company and Saybein have operated in this case under a Joint Prosecution Agreement, attached to the Complaint in this case as Exhibit A. This Joint Prosecution Agreement entered by this Court allowed the plaintiffs to proceed jointly as the real parties in interest in this cause. The actions of the plaintiff Saybein and the prosecution of this case under the Joint Prosecution Agreement have thus been made on both its behalf and that of the other plaintiffs.

3. On August 24, 1990, the plaintiffs instituted this cause against United Capitol for the proceeds of a policy of property insurance which they claimed were due as a consequenceof a fire that occurred on the debtors' prop-

erty on April 17-18, 1989. This property will hereafter be referred to as the Tryon Mall.

4. On September 17, 1990, Saybein served its First Set of Interrogatories and Requests for Production of Documents on United Capitol. These interrogatories and requested documents were directed at the grounds set forth in United Capitol's letter of August 22, 1990, denying coverage for the fire at the Tryon Mall. This letter, signed by counsel for United Capitol—Peter M. Foley of LeBoeuf, Lamb, Leiby & MacRae—was attached to the Complaint as Exhibit G.

5. United States served its answers to these interrogatories and document requests on October 9, 1990.

6. At that time, United Capitol produced only documents which the plaintiffs had transmitted to it before the filing of the lawsuit. United Capitol objected to the production of any further documents on the grounds of either attorney-privilege or, in the case of Request 6, because the request was "overly broad, unclear, and not reasonably calculated to lead to the discovery of admissible evidence."

7. On November 16, 1990, Saybein filed a Motion to Compel pursuant to Fed.R.Civ.P. Rule 37, requesting that United Capitol provide answers responsive to its interrogatories and to produce all requested documents.

8. Also on November 16, 1990, Saybein transmitted its Second Set of Interrogatories and Requests for Production of Documents to United Capitol.

9. Interrogatory 15 and Request 8 of this second set of discovery requests together asked for all documents relating or referring to the "application for insurance, policy of insurance, proof of loss, or denial of coverage in this dispute."

10. Subsequent to the filing of the Motion to Compel and the setting of a hearing on that Motion, United Capitol's counsel provided additional information by way

of letter and agreed to inquire into the existence of further documents. Counsel for Saybein agreed to continue the Motion to Compel pending the receipt of verified supplemental interrogatory responses and the inquiry into the existence of additional documents.

11. Subsequently, on December 14, 1990, United Capitol responded to Saybein's Second Set of Interrogatories and Request for Production of Documents.

12. In response to Interrogatory 15 and Request 8, United Capitol produced a brokerage agreement between it and defendant Brunswick Insurance Companies. It objected to further production on the grounds that Interrogatory 15 was "overly-broad, vague and ambiguous," and further objected to the production of privileged materials.

13. On February 5, 1991, Saybein filed an Amended Motion to Compel to include these portions of the Second Set of Interrogatories and Request for Production of Documents.

14. A hearing on the Amended Motion to Compel was held on February 7, 1991.

15. As of the time of that hearing, United Capitol had not yet supplemented its interrogatory responses to Saybein's First Set of Interrogatories. The only additional documents which it had produced or identified were those set forth in paragraph 12.

16. After the hearing on February 7, 1991, this Court entered its Order, finding as fact that:

> 3. United Capitol's responses did not fully, fairly and adequately meet the substances [sic] of the interrogatories posed. For example, Interrogatory 1 requested United Capitol to identify the dates upon which it became aware of any material fact allegedly concealed by Aubrey G. Nichols, Jr. United Capitol's response was "var-

ious dates up to and including August 20." Its response in this regard was willfully inadequate and in obvious disregard of its duties under the Rules of Civil Procedure.

4. United Capitol, despite assurances to counsel for Saybein—assurances that caused counsel for Saybein to postpone a hearing on its Motion to Compel—has yet to supplement its responses in accordance with the Rules of Civil Procedure in Bankruptcy.

5. As of the date of this hearing, United Capitol has failed to tender any documents other than documents which it received from the plaintiffs.

6. United Capitol's failure in this regard is also an obvious disregard of its duties under the Rules of Civil Procedure in Bankruptcy.

This Court further adopts by reference and incorporates the findings of fact and conclusions of law set forth in the Order which it entered in connection with the February 7, 1991 hearing.

17. No objection was noted to or taken from this Order.

18. This Court ordered United Capitol to comply with all discovery by 12:00 Noon on February 8, 1991, or suffer the imposition of sanctions.

19. By 12:00 Noon on February 8, 1991, United Capitol provided supplemental interrogatory responses and produced approximately 100 pages of documents.

20. At the time of its production, United Capitol's counsel, Charles T. Francis, represented that United Capitol had provided "all the documents, of which I am aware relating . . . or referring to the application for insurance, policy of insurance, proof of loss, or denial of coverage in this matter."

21. It was undisputed at the hearing on this Motion, that during this time counsel for Saybein specifically inquired of counsel for United Capitol about the existence of an "underwriting" file. Counsel for United Capitol responded truthfully that all documents supplied to him by United Capitol had been produced.

22. This Court reconvened its hearing on the Motion to Compel on February 8, 1991 at 2:00 p.m. At that time, counsel for Saybein represented the documents had been produced and that it appeared that United Capitol had complied with this Court's Order, subject to conducting further discovery.

23. This Court consequently continued for further hearing the issue of compliance and sanctions until such time as the parties chose to re-open the issue upon proper Motion and Notice.

24. The depositions of United Capitol personnel—Peggy Brown, Vice President, and William F. Knight, Property Claims Manager—were scheduled by agreement of the parties for 10:00 a.m. on May 16, 1991 in Charlotte, North Carolina.

25. At approximately 9:20 a.m. on May 16, 1991, counsel for United Capitol, Peter M. Foley, tendered to Saybein's counsel a file labeled "underwriting" which contained approximately 210 pages of material. It was undisputed that counsel for United Capitol did not know of the existence of this file until the morning of May 16, 1991, and upon learning of its existence and its contents, tendered the file to Saybein's counsel.

26. The existence of this file was known to United Capitol at all times relevant to this litigation.

27. The documents tendered on May 16, 1991, were subject to this Court's Order of February 7, 1991, and should have been tendered by 12:00 Noon on February 8, 1991.

28. Among the documents tendered on May 16, 1991, was a single-page handwritten memorandum which revealed that United Capitol, as of April 19, 1989, was in possession of material facts which it claimed were concealed by Aubrey G. Nichols in the application for insurance. Approximately one month later, in May 1989, it is undisputed that United Capitol accepted premium for this risk without any reservation of rights.

29. The significance of this document and the subsequent acceptance of premium without reservation of rights is that such action may constitute waiver by United Capitol of any claims concerning fraud and the procurement of the policy based on these facts and may estop it from contesting coverage.

30. Neither this document nor the overwhelming portion of the underwriting file had been produced before May 16.

31. United Capitol was in possession, custody and control of the "underwriting" file at all times relevant to this litigation and was capable of producing these documents.

32. United Captiol has proffered no reason for its delayed production of this file until the moment before deposition other than arguing now, for the first time, that some of the documents produced in the underwriting file are not relevant. It was undisputed that counsel for United Capitol produced the file immediately upon learning of its existence and contents and thus was not responsible for the delay in production.

33. Depositions of Brown and Knight taken on May 16, 1991 reveal the existence of two other files of United Capitol which had not been produced:

a. A "claims file," estimated by Knight to be as thick as the underwriting file produced on May 16;

b. An "original file" concerning the conditions for the issuance of coverage for certain risks such as the Tryon Mall kept in the possession of Brown.

34. Neither file, as of the date of this hearing, has been produced by United Capitol, nor has any claim of privilege been made or any motion for protective order filed.

35. These files, copies of which were not tendered to the Court, are from their description by Brown and Knight within the scope of this Court's Order entered after the hearing of February 7, 1991.

36. The existence of these files was known to United Capitol at all times relevant to this litigation.

37. United Capitol was in possession, custody and control of these files at all times relevant to this litigation and was capable of producing these documents.

38. United Capitol has, in its responses to interrogatories and production of documents, deliberately and willfully ignored its obligation under the Rules of Civil Procedure. Specifically:

a. United Capitol's responses to the First Set of Interrogatories were in willful and flagrant disregard of its duties under the Rules of Civil Procedure;

b. United Capitol's refusal to tender its own documents—documents other than those supplied to it by the plaintiffs and the Brokerage Agreement —until ordered to do so by this Court was also in willful and flagrant disregard of its duties under the Rules of Civil Procedure;

c. United Capitol's failure to seasonably supplement its interrogatory responses until ordered to do so by this Court was also in willful and flagrant disregard of its duties under the Rules of Civil Procedure.

39. United Capitol, in its response to this Court's Order issued in connection with the hearing of February 7, 1991, has deliberately and willfully ignored its obligations under that Order. Specifically:

a. United Capitol's conduct in not producing its underwriting file when ordered to do so, in delaying 90 days and until the moment before deposition the production of this file, and producing twice as much material the moment before deposition as it had produced earlier under this Court's Order indicates a flagrant and willful disregard for this Court's Order;

b. United Capitol's continued failure to produce, or even tender to this Court, its "claims file" and its "original file," represents a continuing, flagrant and willful disregard for this Court's Order.

40. United Capitol's actions as set forth above are made even more egregious by the fact that a document of substantial significance and importance to this case was not produced until the moment before its employees were to be deposed and, at that time, was produced among a stack of approximately 210 pages of documents. The handwritten memorandum of April 19, 1989 was a document which United Capitol was required to produce under the Rules of Civil Procedure in October 1990. It was a document which United Capitol was ordered to produce by February 8, 1991.

41. United Capitol's actions in this regard lead the Court to conclude that it willfully and deliberately concealed the existence of this document from the plaintiffs.

42. The response of United Capitol's counsel to these matters in now claiming that many of these documents are not relevant, that counsel for Saybein was not prejudiced by the late production because counsel for Saybein had one hour to study the 210 pages, and that it is United Capitol which should receive attorneys' fees, in

light of counsel's responses to the First Set of Interrogatories and its failure to ascertain reasonably and adequately that its representations as to the existence of additional documents to plaintiffs' counsel and this Court were correct, indicate that counsel for United Capitol has also ignored its obligations under Fed.R.Civ.P. Rule 26(g) and this Court's Order, requiring the assessment of expenses, including reaonable attorneys' fees.

43. United Capitol and the law firm of LeBoeuf, Lamb, Leiby & MacRae have further failed to demonstrate pursuant to Fed.R.Civ.P. Rule 37(b)(2) that their failures as set forth in this Order were either substantially justified or that other circumstances exist so as to make the awarding of expenses, including attorneys' fees, unjust.

Based upon these foregoing findings, this Court, in its discretion pursuant to Fed.R.Civ.P. Rule 37(b)(2) and Rule 26(g), is of the opinion that Saybein's Motion, on behalf of all plaintiffs, should be granted. This Court has considered the imposition of sanctions other than the striking of United Capitol's pleadings and the awarding of attorneys' fees, but has concluded, in its discretion, that there is no reasonable expectation that such "lesser" sanctions would either remedy the defaults noted in this Order or would adequately meet, redress and deter other conduct in the future, both by this party and other parties. This is particularly true in light of United Capitol's failure to comply with this Court's Order following the hearing of February 7, 1991, even under the threat of sanctions, and its continued failure to produce documents even as of the date of this hearing.

WHEREFORE, IT IS HEREBY ORDERED, ADJUDGED AND DECREED that:

1. The pleadings of United Capitol in this cause, including its Answer to the Amended Complaint, shall be

and are hereby stricken pursuant to Fed.R.Civ.P. Rule 37(b)(2)(C);

2. A judgment by default against United Capitol shall be entered on behalf of the plaintiffs pursuant to Fed.R. Civ.P. Rule 37(b)(2)(C) in the following manner:

a. The plaintiffs shall have and recover of the defendant United Capitol Insurance Company the sum of $273,424 plus interest at the legal rate for March 15, 1990 through the date of this Order;

b. The plaintiffs shall have and recover of the defendant United Capitol Insurance Company post-judgment interest at the legal rate from the date of this Order through the date of satisfaction of the judgment;

c. The costs of this action shall be taxed against the defendant United Capitol Insurance Company.

3. United Capitol and LeBoeuf, Lamb, Leiby & MacRae shall, jointly and severally, be ordered to pay the reasonable expenses, including attorneys' fees, of the plaintiffs in connection with this litigation. The plaintiffs are directed to serve upon both United Capitol and the law firm of LeBoeuf, Lamb, Leiby & MacRae, their application for attorneys' fees and supporting documentation. United Capitol and LeBoeuf, Lamb, Leiby & MacRae shall serve their responses to these applications, including any supporting materials, within seven (7) days of the date of service. This Court shall thereafter conduct a hearing on the amount of expenses and fees to be awarded.

This 17th day of June, 1991.

/s/ Marvin R. Wooten
MARVIN R. WOOTEN
United States Bankruptcy Judge

Filed October 18, 1994

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 93-1753
CA-91-231-3-MU
CA-91-251-3-MU

IN RE: NICHOLS & ASSOCIATES TRYON PROPERTIES, INCORPORATED; IN RE: SAYBEIN PARTNERS, a New York General Partnership,

Debtors

NICHOLS & ASSOCIATES TRYON PROPERTIES, INCORPORATED; TRYON ASSOCIATES, LIMITED; CONNECTICUT MUTUAL LIFE INSURANCE COMPANY; SAYBEIN PARTNERS,

Plaintiffs-Appellees

v.

UNITED CAPITOL INSURANCE COMPANY,
Defendant-Appellant

BRUNSWICK INSURANCE AGENCY, INCORPORATED, d/b/a The Brunswick Companies; BLUE RIDGE INSURANCE SERVICES AGENCY, INCORPORATED; WILLIS E. FICKEY,
Defendants-Appellees

and

PILOT PROPERTY CASUALTY AGENCY, INCORPORATED,
Defendant

ON PETITION FOR REHEARING WITH
SUGGESTION FOR REHEARING IN BANC

The appellant's petition for rehearing and suggestion for rehearing in banc were submitted to this Court. As no member of this Court or the panel requested a poll on the suggestion for rehearing in banc, and

As the panel considered the petition for rehearing and is of the opinion that it should be denied.

IT IS ORDERED that the petition for rehearing and suggestion for rehearing in banc are denied.

For the Court,

/s/ Bert M. Montague
Clerk

[Filed Jun. 18, 1991]

IN THE UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NORTH CAROLINA
CHARLOTTE DIVISION

Case No. C-B-89-30349
(Chapter 11)

IN RE: NICHOLS & ASSOCIATES TRYON PROPERTIES, INC.,
Debtor.

Case No. C-B-90-30579
(Chapter 11)

IN RE: SAYBEIN PARTNERS, c/o EMES Management Corporation, 919 Third Avenue, New York, New York 10022, a New York General Partnership,
Debtor.

NICHOLS & ASSOCIATES TRYON PROPERTIES, INC., TRYON ASSOCIATES LIMITED, CONNECTICUT MUTUAL LIFE INSURANCE COMPANY and SAYBEIN PARTNERS,
Plaintiffs,

vs.

UNITED CAPITOL INSURANCE COMPANY, BRUNSWICK INSURANCE AGENCY, INC., d/b/a THE BRUNSWICK COMPANIES, BLUE RIDGE INSURANCE SERVICES AGENCY, INC., PILOT PROPERTY & CASUALTY AGENCY, INC., and WILLIS E. FICKEY,
Defendants.

JUDGMENT

THIS JUDGMENT is entered by this Court based upon its Order striking the pleadings of the defendant United Capitol Insurance Company pursuant to Fed.R.Civ.P. Rule 37(b)(2)(C) and Rule 54(c). This Order is adopted by reference and incorporated into this Judgment.

WHEREFORE, IT IS ORDERED, ADJUDGED AND DECREED that:

1. The plaintiffs shall have and recover of the defendant United Capitol Insurance Company, the sum of Two Hundred Seventy Three Thousand Four Hundred Twenty Four Dollars ($273,424) plus interest at the legal rate from March 15, 1990 through the date of this Order;

2. The plaintiff shall have and recover of the defendant United Capitol Insurance Company interest at the legal rate from the date of this Order through the date of satisfaction of this Judgment;

3. The costs of this action shall be taxed against the defendant United Capitol Insurance Company.

This 17th day of June, 1991.

/s/ Marvin R. Wooten
MARVIN R. WOOTEN
United States Bankruptcy Judge

[Filed Jul. 25, 1991]

UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF
NORTH CAROLINA
CHARLOTTE DIVISION

Case No. 89-30349
(Chapter 11)

IN RE: NICHOLS & ASSOCIATES TRYON PROPERTIES, INC.,
Debtor.

Case No. 90-30579
(Chapter 11)

IN RE: SAYBEIN PARTNERS, c/o EMES Management Corporation, 919 Third Avenue, New York, New York 10092, a New York General Partnership,
Debtor.

Adversary Proceeding No.: 90-0206

NICHOLS & ASSOCIATES TRYON PROPERTIES, INC., TRYON ASSOCIATES LIMITED, CONNECTICUT MUTUAL LIFE INSURANCE COMPANY and SAYBEIN PARTNERS,
Plaintiffs,

vs.

UNITED CAPITOL INSURANCE COMPANY, BRUNSWICK INSURANCE AGENCY, INC., d/b/a THE BRUNSWICK COMPANIES, BLUE RIDGE INSURANCE SERVICES AGENCY, INC., PILOT PROPERTY & CASUALTY AGENCY, INC., and WILLIS E. FICKEY,
Defendants.

ORDER MODIFYING JUDGMENT ENTERED JUNE 18, 1991

This adversary proceeding came on to be heard before the undersigned United States Bankruptcy Judge on July 17, 1991 upon the motion of Defendant United Capitol Insurance Company ("United Capitol") for relief from the judgment entered by this court on June 18, 1991.

The court finds that the motion for reconsideration should be, and is hereby, allowed. The Order of June 18, 1991 will be reentered with limited modification.

As to the joint and several liability assessed against the law firm of LaBoeuf, Lamb, Leiby & MacRae and United Capitol for attorney's fees in the previous Order, this Order shall serve to modify that provision and assess liability for said fees solely against United Capitol.

As to the court's decision to strike the answer of United Capitol and enter a default judgment against the Defendant, said sanctions, while very severe and substantial, are appropriate in this instance. It is important to recognize that we are not dealing with an inexperienced, uneducated defendant. Instead, we have a large and sophisticated insurance agency, an entity well aware and informed as to what is required to comply with the letter and spirit of discovery requests.

The level of sanctions imposed in a given matter vary with the sophistication of the entity against whom the sanctions are assessed. It would not send the proper message to this type of defendant if the court were to allow the case to proceed and then to assess sanctions upon its completion. This court recognizes that the defendant has valid defenses and a right to put them forward just as the plaintiff has valid arguments and the same right to present its case fully. Even so, the court determines that it is more than justified in striking defendant's answer and entering a judgment of default. Rarely has this court

seen such a flagrant abuse of, and callous disregard to, the spirit of discovery.

IT IS SO ORDERED.

This the 24th day of July, 1991.

/s/ Marvin R. Wooten
United States Bankruptcy Judge

STATUTES AND REGULATIONS INVOLVED

28 U.S.C. § 1334(b) (1988):

> Notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.

28 U.S.C. § 157(c) (1988):

> (1) A bankruptcy judge may hear a proceeding that is not a core proceeding but that is otherwise related to a case under title 11. In such proceeding, the bankruptcy judge shall submit proposed findings of fact and conclusions of law to the district court, and any final order or judgment shall be entered by the district judge after considering the bankruptcy judge's proposed findings and conclusions and after reviewing de novo those matters to which any party has timely and specifically objected.
>
> (2) Notwithstanding the provisions of paragraph (1) of this subsection, the district court, with the consent of all the parties to the proceeding, may refer a proceeding related to a case under title 11 to a bankruptcy judge to hear and determine and to enter appropriate orders and judgments, subject to review under section 158 of this title.

Fed. R. Bankr. P. 7008(a):

> *Applicability of Rule 8 F.R. Civ. P.* Rule 8 F.R. Civ. P. applies in an adversary proceedings. The allegation of jurisdicton required by Rule 8(a) shall also contain a reference to the name, number, and chapter of the case under the Code to which the adversary proceeding relates and to the district and division where the case under the Code is pending. In an adversary proceeding before a bankruptcy

judge, the complaint, counterclaim, cross-claim, or third party complaint shall contain a statement that the proceeding is core or non-core and, if non-core, that the pleader does or does not consent to entry of final orders or judgment by the bankruptcy judge.

Fed R. Bankr. P. 7012(b):

Applicability of Rule 12(b)-(h) F.R. Civ. P. Rule 12(b)-(h) F.R. Civ. P. applies in adversary proceedings. A responsive pleading shall admit or deny an allegation that the proceeding is core or non-core. If the response is that the proceeding is non-core, it shall include a statement that the party does or does not consent to entry of final orders or judgment by the bankruptcy judge. In non-core proceedings final orders and judgments shall not be entered on the bankruptcy judge's order except with the express consent of the parties.